RURAL SAVINGS MOBILIZATION AND RURAL CREDIT STUDY

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FINANCIAL MARKETS IN RURAL ZAIRE: AN ASSESSMENT OF THE BANDUNDU AND SHABA REGIONS

Final Report

EXECUTIVE SUMMARY

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EXECUTIVE SUMMARY

This comprehensive assessment of rural finance reviews the functioning of formal and informal financial markets in Bandundu and Shaba. The access to financial services by the rural population, and the activities of formal and informal financial intermediaries were investigated through extensive field surveys in the two regions. Rural household surveys, interviews with bankers, managers of credit unions, leaders of informal financial groups, and individuals engaged in informal financial intermediation such as traders and moneykeepers provided the data base for the analyses carried out in the study.

The study first addressed the question of access to and demand for financial services by rural households and enterprises, focusing primarily on credit and deposit services. In addition, the viability and performance of financial intermediaries, and the nature and extent of the linkages between these intermediaries were documented and analyzed.

The findings revealed the limited role of formal financial institutions as suppliers of financial services for rural households. Among these institutions, the only sector that emerged as a promising base for financial development in rural areas is the credit union network currently in place in both Bandundu and Shaba. At the same time, the study documented substantial and highly monetized activity in the informal financial markets of the two regions. Informal financial groups, moneykeepers/moneylenders, traders, and direct transactions between rural households are the major components of non-institutional finance in rural areas. Despite the significant activity of informal intermediaries, the findings discovered a considerable potential for financial market growth in the areas under analysis.

A. Rural Household Finance in Bandundu and Shaba

Households interviewed in the Bandundu region obtained average gross revenues of about 160 thousand zaires the year preceding the date of the interview (approximately 320 US$), of which 70 percent came from agricultural activities. Major sources of non-agricultural revenues were salaries earned in off-farm work and commerce. This average household income implies an estimated income per capita for rural households in Bandundu of about 64 US$ per year. Estimated annual gross revenue for Shaba rural households is roughly 690 thousand zaires (approximately 1380 US$), equivalent to 172 US$ per capita (i.e., 2.5 times that estimated for Bandundu). Sixty-three percent of total gross household revenues in the Shaba region came from agriculture, while commerce was by far the major source of non-agricultural gross earnings for Shaba rural households.

1. Access to Credit

Less than 3 percent of the households interviewed in Bandundu and less than 5 percent of those interviewed in Shaba had ever received an institutional loan. In an average year, two out of every one thousand rural households receives a loan from a formal financial institution in Bandundu, while in Shaba 15 out of every one thousand households borrow from institutions. It must be pointed out that credit unions and development projects are included in the institutional category of sources of credit in this study, hence the rate of access to bank loans by rural households is even lower than that indicated for all financial institutions. Moreover, the limited access to institutional sources of credit by rural households underscores one of the serious weaknesses of the credit-union movement, namely, the failure to perform a significant role in the supply of loanable funds to rural areas.

Moneylenders and traders are fairly active and well known suppliers of credit to rural households in both Bandundu and Shaba. One-fourth of the households in Bandundu and almost one-half of the households in Shaba were aware of the activity of moneylenders in the community. In addition, about one-third of the households in both regions had received advances towards the sale of agricultural products from market traders at some point in the past. Similar proportions in the two samples were found for credit received from input traders and retailers of consumer goods. However, when identifying the latest source of informal loans or assistance, the respondents emphasized relatives and friends as the most important suppliers of finance.

Overall, 41 percent of the households in Bandundu, and 61 percent of the Shaba respondents had received an informal loan in the year preceding the interview. After adjusting for multiple loans received by some households, the rate of access to informal credit is estimated at 32 percent for Bandundu and 49 percent for Shaba.

In both regions, informal loans were received in cash in most cases, and reimbursement of loans (also in cash) was clearly specified in almost all transactions. Among the loans to be reimbursed, less than one-fifth carried interest charges, which averaged 25 percent per month in Bandundu and 37 percent per month in Shaba. No collateral was specified in the loan transactions. However these loans were arranged in front of witnesses in 35 percent of the loans documented in Bandundu and 20 percent of those reported in Shaba. Consumption, medical and school expenses accounted for almost 60 percent of the loan use in both regions. The financing of funerals and weddings represented the next most important use of funds in Bandundu (10 percent of the loans), while trade financing was the next most important use of informal credit in Shaba (17 percent of the transactions). Transportation and other production-related activities represented between 7 and 8 percent of the use of these loans.

The findings reported above reveal an active and fairly monetized informal credit market in the two regions under analysis, especially in the Shaba region. It is important to highlight the level of interest rates charged on these operations. Monthly interest rates of 25 to 37 percent can reach between 300 and 440 percent per year if these monthly rates are annualized.[1] However, all loans documented were typically of less than three-months term and it was clear from the field interviews that neither lenders nor borrowers have annualized interest rates in mind when performing informal credit transactions. Moreover, what may appear to be relatively high monthly interest rates may not be very high when the activity financed has a high turnover with a rate of return that supports these charges. In this sense it is inappropriate and misleading to compare these monthly rates to longer term formal rates of interest.

2. Access to Deposit Services

Awareness and use of depository institutions by rural households was limited but substantially more frequent than that observed for these institutions as sources of credit for these households. Less than 11 percent of the respondents held deposits at institutions in Bandundu, primarily at credit unions (9 percent of all interviews), while 7.3 percent of the Shaba respondents held institutional savings. In the latter region, the relative importance of credit unions was similar to that of CADEZA (about 2.5 percent of the interviews in each case), whereas in Bandundu the activity of CADEZA was practically non-existent.

In the non-institutional sector, two important forms of informal deposit/safekeeping services were identified and documented through the rural household survey namely, informal financial groups and moneykeepers. Almost 25 percent of the respondents in Bandundu participated in an informal financial group at the time of the interview, and at least one other member of the household was active in a group in 17 percent of the cases. In addition, about one-fourth of the respondents personally knew a moneykeeper, while almost 60 percent of these respondents acknowledged holding deposits with moneykeepers (i.e., about 14 percent of all respondents used moneykeeper services).

In Shaba, 18 percent of the respondents belonged to an informal group, with another member of the household participating in a group in 13 percent of the cases. In this region, moneykeepers were substantially more common than in Bandundu, since about 54 percent of the respondents knew of the existence of moneykeepers and, of these respondents, one-half held deposits with them. This implies moneykeeping services were used by about 28 percent of the total sample in the Shaba region.

Another significant use of liquidity by rural households was the provision of loans to other households in the area. In fact, this alternative was found to be more important, in terms of the proportion of households and the amounts involved, than holding deposits with institutions or in the informal market. Fifty-one percent of the households interviewed in

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[1] Inflation rate was about 150 percent the year preceeding the interview.

Bandundu, and 75 percent of those in the Shaba sample had been informal lenders in the year preceding the interview. Average amounts lent were similar or higher than the amounts borrowed by rural households, and interest charges, although infrequent, were as high as those reported for loans received from informal sources.

Both institutional and especially non-institutional savings are far from negligible in the two regions under analysis. The use of credit union services, the participation in informal groups, and the use of moneykeeping services highlight the effective demand for financial services in rural areas. Notwithstanding the active participation by rural households in informal finance, the findings indicate that physical assets, primarily livestock, are still the dominant form of liquid and semi-liquid assets held by these households. Assets held in financial form, i.e., in deposits in formal or informal intermediaries, or in loans to other households, account for a minor proportion of total household liquid and semi-liquid assets (about 16 percent in Bandundu, and 28 percent in Shaba). This result underscores the potential for expanding and improving the availability and quality of financial savings in rural areas.

B. Financial Intermediaries in Bandundu and Shaba

As indicated above, formal financial institutions play a minor role in the direct provision of financial services to the rural population in Bandundu and Shaba. However, their potential role in financial market development through linkages with semi-formal institutions (e.g., credit unions), wholesale traders, and other informal intermediaries, should not be overlooked.

The study indicates that credit activity of banks and non-bank financial institutions is biased towards the more developed sectors of the economy, i.e., trade, services, industry and the marketing of agricultural products. Enterprises are the major customers of the formal financial market, especially in Shaba, although individuals are also an important source of deposits in formal markets. Access to formal credit by low-income people both in towns and villages is practically non-existent. Not only do banks consider these people a poor credit risk, but the lengthy procedures followed and the terms and conditions required by banks discourage rural people from even applying for loans. The ruling interest rates in banks are not an obstacle for access by this class of customers to formal credit, since interest rates in credit unions and informal intermediaries are often considerably higher than those applied on bank loans.

Evaluation of management and the viability of formal financial intermediaries operating in the two regions indicated that the major private banks have succeeded in adapting their organization to the activities they finance. Nevertheless, the strong centralization of operations in Kinshasa is considered by branch officers to be a serious limitation. This reduces flexibility in the relationship between head offices and branches, and between branches and their customers.

The results confirmed four working hypotheses about formal financial institutions set forth at the outset of the study: (a), formal financial institutions are net exporters of liquidity from the regions to their head offices; (b), among the resources employed locally, credit granted to the agricultural sector is primarily allocated to marketing rather than production; (c), banks play a limited and one-sided role in linking the credit union system and informal intermediaries to the formal financial market only through deposit and not loan activity; (d), bank specific deposit mobilization activity is practically non-existent among the rural clientele. These results underscore the importance of relying upon other financial intermediaries, i.e., savings and credit cooperatives (credit unions) and informal intermediaries. for the provision of direct (retail) financial services in rural areas. Developing appropriate linkages between these intermediaries and the banking system as wholesaler of financial services will facilitate market integration and improve overall financial intermediation.

1. Savings and Credit Cooperatives

The credit union movement in the Bandundu region is very active. The COOPEC/COOCEC system and specially the CPK are rapidly growing in savings mobilization, and have clearly substituted for the banking system. Together, these cooperatives provide services to about 45,000 members/customers. Their link with the banking system is mostly through deposits held in commercial banks and the intermediation role played by commercial banks in the purchase of treasury bills by the credit unions. On the lending side, banks are very cautious in accepting credit unions as borrowers, apparently due to the insufficient degree of credit union regulation by the B.Z. Credit unions, in turn, are not very interested in borrowing from banks, given their low loan/deposit ratio (i.e. a high liquidity position). In fact, credit unions are not significantly involved in lending to their members and, instead, invest considerable amounts of funds in treasury bills, in bank deposits, or keep their excess savings in cash. This reflects a risk-averse management of member savings along with a limited capacity to evaluate the risk associated with local requests.

Both the COOPEC/COOCEC network and the CPKs show impressive growth in membership in recent years, with an increasing proportion of female members and, interestingly, of informal groups participating as members. These linkages are particularly important mechanisms to enhance and improve financial intermediation. In fact, they allow more widespread monetary circulation that otherwise would be constrained to the local areas and occupational groups inherent in the limited scope of membership in informal groups.

The credit union system in Shaba is very heterogeneous. The COOPEC/COOCECs system has almost disappeared, but two important organizations, the UCPD and the CPCT, are operating actively in the region, providing financial services to about 50,000 members. These two organizations mobilize large amounts of deposits but, as was the case in Bandundu, still need to improve and extend their lending activity. The CPCT is the strongest movement and, given its limited territorial coverage, has good possibilities for expansion through the extension of its network.

The credit union linkage with the banking system seems stronger in Shaba than in Bandundu. Credit unions generally hold deposits in commercial banks and occasionally receive loans from these banks. Their need for external sources of funds from the banking system is, however, very limited since credit unions are highly liquid. As was the case in Bandundu, credit unions also use banks as intermediaries in the purchase of large amounts of treasury bills.

The savings and credit cooperatives in Shaba, particularly the CPCT system, are dynamic and promising as sources of growth for the financial system. These cooperatives experienced substantial growth during the last decade, and have established important connections with informal groups as members of cooperatives. As is the case in Bandundu, the cooperative sector in Shaba appears to offer the best grounds for donor assistance in the area of financial and information management. The rapid growth and diversification of economic activity in Shaba should play a positive role in further developing rural financial markets in this region.

The generalized success credit unions have demonstrated in mobilizing local savings in the rural economy not reached by formal institutions is not accompanied by a similar performance in lending. Hence, credit unions only partially perform their intended role and contribute to the transfer of substantial amounts of funds from rural areas to other sectors of the economy, mainly the Treasury (thus supporting the financing of government expenditure). Credit unions have several advantages over the banking system. They operate in a restricted region and have direct and immediate relationships with customer/members. The informational advantages enjoyed by credit unions translate into reduced transaction costs for both credit unions and their members. However, credit-union viability is a concern and currently a weak point if compared to the profitability and self-sustainability of private banks. With few exceptions, all credit unions reviewed here are suffering losses and do not seem likely to recover in the short-run.

In summary, credit unions are at present the only formal financial institution that succeeds in servicing people neglected by the banking system. Their success in terms of membership dynamics and savings mobilization is striking. Unfortunately this success has not been accompanied by a satisfactory financial performance that would allow these institutions to attain stability and continue operating in the long run. The achievement of a higher degree of stability of the credit union system, would favor both the development of the movement and its relationship with the banking system. Banks restrain from stronger linkages with credit unions because they are not confident in the ability of credit unions to survive. The role of donors in this respect can be important. Interventions aimed at improving credit-union management and procedures would be much more effective than a generic financing of their budget, which would perpetuate their low viability and increase their dependence on external support.

2. Informal Financial Intermediaries

Informal financial intermediaries play a central role in rural financial markets in Bandundu and Shaba. Rotating and non-rotating savings and credit associations (informal financial groups), moneykeepers/moneylenders, and traders are of crucial importance in funds mobilization and in the provision of credit and depository services to rural households. Several informal financial groups (IFGs) exist per village (e.g., 5 on average in Bandundu), each mobilizing on average between 250 thousand and 3 million zaires per group per year. These amounts of funds per IFG are equivalent to mobilizing between 30 thousand zaires (Bandundu) and 100 thousand zaires (Shaba) per group member, amounts equivalent to about 15 percent of total gross household income. Moneykeepers/moneylenders, also abundant in rural areas, mobilize on average between 250 thousand and 1.2 million zaires per year, each servicing a clientele that fluctuates between 10 and 60 or more rural households.

Credit appears to be an important component of marketing transactions between traders and farmers in the two regions under study. Traders in Bandundu reported that the value of the credit advanced against purchases from farmers was over 50 percent, while in Shaba, the value of the credit advanced against the value of purchases was 20 percent. Traders were also somewhat active in providing credit that was not related to their business. Unlike informal groups, traders are well connected both with formal as well as informal financial intermediaries. More than half of the traders interviewed in Bandundu received credit from informal financial intermediaries, and over 30 percent from formal financial institutions. Although borrowing from either formal or informal financial intermediaries was less common in Shaba, access by traders to deposit services of formal financial institutions in both Bandundu and Shaba was fairly significant.

The traditional view of informal financial intermediaries being exploitative and usurious is clearly not supported by our findings. The terms and conditions of loans given by the various informal financial intermediaries characterize the typical loan as varying in size, with no collateral, and flexible in term length. Interest charges, when they exist, reflect the market conditions and are comparable to interest charges by cooperatives and commercial banks, or to interest charges in direct loan transactions between rural households. The lack of collateral requirements and the nature of the interest charges clearly points to the greater efficiency in information, monitoring, and enforcement of contracts by informal financial intermediaries. Deposit services provided by the informal groups and moneykeepers, although with no form of guarantee on deposits, are given at very low or no cost to the members or clients. The performance of informal financial intermediaries is undoubtedly superior to that of formal financial institutions in delivering financial services to the rural population.

C. Major Implications and Recommendations

The findings reported here reveal, on the one hand, the non-existence of institutional credit services accessible to rural households and, on the other hand, the presence of clearly visible informal credit transactions in rural areas. An active and highly monetized informal credit market exists in the two regions. Rural households engage not only in informal borrowing from various sources, but also in active lending to other households in the area. Interest rates, when made explicit in these informal transactions, are substantially higher than those involved in the lending operations of formal financial institutions. The extensive informal credit activity documented in this study underscored clearly an effective demand for credit services in rural areas.

Rural households also engage in substantial savings activities, primarily with non-bank financial institutions, notably credit unions, informal financial groups and individual informal intermediaries (moneykeepers). As indicated above for credit services, the findings associated with deposit activities indicate an effective demand for deposit services and therefore for financial intermediation in the rural areas of Bandundu and Shaba.

The credit union network and the informal financial groups (IFGs) appear as the most promising modes of financial intermediation in rural areas. At the same time, individual informal intermediaries such as moneykeepers/moneylenders and traders play an important role in establishing indirect connections between informal and formal intermediaries.

The COOPEC/COOCEC network and the CPK system in Bandundu, as well as the CPD/UCPD and the CPCT organizations in Shaba offer, in spite of several current limitations, the most promising base for donor assistance in the areas of financial and information management techniques. The sustained growth observed in the credit union network, the increasing involvement of women in credit union membership and, even more significantly, the linkages with local informal groups are key positive factors in the assessment of the potential role that credit unions can play in promoting financial market development.

Female participation and leadership are even more significant in informal financial groups. The study findings indicate that these groups mobilize significant amounts of liquidity in their areas of activity and provide reliable and stable financial services to their members. Their linkages with the credit union network and in general with the formal financial system are to be encouraged and supported.

Both governmental and donor support should seriously consider initiatives that favor the strengthening and development of the informal sector, without undermining the basic foundation of their success. In this respect, the incipient and growing linkages observed between informal groups and the credit union network provide a promising ground for donor and government intervention. Likewise, establishing efficient linkages between credit unions and informal intermediaries on the one hand, and the banking system on the other hand, will reduce financial market fragmentation and substantially improve financial intermediation in rural areas. The specific recommendations outlined below focus on the development of these multi-lateral linkages, and on the strengthening of the credit union movement as the central link in the financial intermediation chain.

1. Strengthening the Credit Union Movement

The COOPEC/COOCEC and CPK organizations in Bandundu, as well as the CPD/UCPD and the CPCT networks in Shaba provide a promising base for the strenghthening of the credit union movement in these two regions. Support to these institutions should focus on improving their infrastructure and equipment, increasing the skill levels of their management staff, and developing their information management systems. Accounting, record keeping, portfolio management, and lending procedures are areas where savings and credit cooperatives could improve the most. As pointed out below, creation and adoption of improved deposit instruments and loan contracts would greatly enhance the role credit unions play in rural financial markets.

Successful credit-union movements in Africa, notably the CamCCUL organization in Cameroon, and the FUCEC system in Togo should be used as models to follow for the Zaire organizations. The COOCEC Bandundu may have direct access to these organizations through UCCEC (the national federation) and the African confederation (ACCOSCA). The other Zairean organizations indicated above, not affiliated to UCCEC, will require the establishment of direct relationships with the Cameroon and/or Togo movements to benefit from their experience and resources. Institutions currently assisting CamCCUL and FUCEC should also be contacted to design training and promotion schemes aimed at expanding and improving the Zairean credit-union movement.

2. Linkages between Credit Unions and the Informal Sector

The growing linkages between savings and credit cooperatives and informal financial intermediaries documented in this study are to be developed and strengthened through two primary lines of action: (a), the creation of appropriate financial instruments, and (b), the ellimination or reduction of existing constraints for bi-lateral transactions between credit unions and informal intermediaries.

First, credit unions should develop attractive deposit instruments that meet the needs of informal groups and other intermediaries in term structure and remuneration. Informal groups typically need to safekeep emergency funds or reserves for specific lengths of time. They would benefit if matching deposit instruments were offered to them by credit unions, yielding a return that deposit alternatives elsewhere do not provide. Likewise, village moneykeepers would welcome the option of depositing money in highly liquid, flexible term, accounts which would help them manage their overall cash flow. A similar type of account would favor the individual portfolio management of rural traders.

Second, credit services from cooperatives to informal intermediaries should be substantially improved in order to establish a solid bi-lateral relationship between cooperatives and their "clients". This relationship should replace the current unidirectional flow of savings from intermediaries to cooperatives (and subsequently to the Treasury, as documented here). The reluctance of credit unions to lend to informal groups (and to their own members) is based both on risk and return considerations (as their preference for tresury bills indicates). Therefore, credit policies and loan contracts should be modified to address these two considerations. Many credit unions already apply market interest rates on their loans to members (e.g., the CPKs in Bandundu), but the risk of arrears and default is still a deterrent to expand lending to more members and to informal groups. A suitable risk-reducing mechanism to alleviate this constraint is the establishment of guarantee funds and other collateral-substitute schemes for credit-union loans.

Again, on-going initiatives elsewhere in Africa provide useful insights into the design and impementation of these mechanisms. A guarantee fund established with USAID support at the BIAO-Niger for rice cooperatives, with technical assistance provided by the National Cooperative Business Association (NCBA, formerly CLUSA) has shown reasonable success and potential. Likewise, there are at least two examples of credit-union lending to informal groups, and to informal-group members, in the Cameroon credit union movement. In one case, the Lywontse Association in the Nkar province, guarantee funds and technical assistance are contributed by the German cooperation agency (GTZ). The other example corresponds to a guarantee provided by CamCCUL to a member cooperative in Douala, which in turn guarantees loans obtained by members of informal groups from a third (public) financial institution. All members of the group collectively co-sign for the individual borrower, a mechanism accepted by the credit cooperative.

In summary, guarantee-funds, collective co-signature ("caution mutuel"), third-party co-signature, and other collateral substitutes are feasible alternatives perfectly applicable in the cooperative sector. Informal groups and other informal intermediaries may gain significant access to credit union loans through these guarantee mechanisms.

3. Linkages between Credit Unions, the Banking System, and other Financial Intermediaries

Establishing and improving linkages between banks, credit unions and other financial intermediaries can be attained through similar strategies as those outlined above for credit unions and informal intermediaries. In this case, however, deposits in banking institutions are a common practice by credit unions. The major constraint is represented by the lack of access to bank funds by these credit cooperatives.

Banks could also improve the selection of deposit instruments they offer to credit unions and other potential depositors, to better match their requirements in term structure and return. Deposit mobilization by banks, however, is seriously discouraged by current central bank regulations, especially reserve requirements, which impede further integration among financial intermediaries.

Efforts to improve credit-union access to bank funding could follow similar schemes as those indicated above for credit unions and informal groups. The USAID-CLUSA-BIAO pilot project in Niger is a particularly pertinent model to consider in this respect. Strengthening the credit union movement in the ways recommended above would facilitate the implementation of this model.

D. A Strategy for Credit Union Development

A strategy that compiles and implements the three major recommendations set forth above should be designed in full detail with the assistance of credit union expertise such as that provided by the World Council of Credit Unions (WOCCU). However, the findings and insights contributed by this study allow laying out the objectives, the major components and stages of this strategy, as well as some tentative goals for the initial stages.

A central element of the proposed strategy is the reliance upon existing USAID/GOZ project infrastructure and staff, specifically those of Project 102 in Bandundu, and Project 105 (Agriculture) in Shaba, and their associated NGOs. Furthermore, the scope of this support program is conceived as gradually increasing in its coverage of both existing and newly created credit unions, so that no major reallocations of project/NGO resources are anticipated. As suggested below, only a group of selected credit unions would participate at the onset of the program. This gradual approach allows for continuous monitoring and evaluation, and helps develop self-sustaining structures in the credit union movement capable of taking over the development program in the future. A description and discussion of the strategy objectives, components and stages follows.

1. Objectives

The major objective of this strategy is the development and strengthening of the credit union movement in Bandundu and Shaba, so that it can constitute a solid base for rural financial intermediation in both regions. The general goal of this program is to significantly increase the access to deposit and credit services by the rural population in the two regions.

Specific objectives of this development strategy are: (a), to improve credit union administration, procedures, and infrastructure; (b), to increase membership and membership participation in credit unions, emphasizing enhanced women membership and participation; (c), to substantially increase savings mobilization through credit unions; (d), to significantly improve credit services to credit union members, and (e), to improve credit-union market integration, horizontally through better linkages with other credit unions, and vertically through new and improved linkages with informal intermediaries (downward integration), and with the banking system (upward integration).

2. Components

The strategy components can be grouped in three major categories: (i), funding, primarily to meet objective (a), (ii), conditionality rules associated with this financial assistance, designed to induce policy reforms and changes in managerial practices addressing objectives (b) through (e), and (iii), removal of constraints external to the credit union movement, such as those implicit in the BZ Ordinance Number 1.

(i) Funding

In order to meet objective (a) above, it is essential that funding (possibly grant funds) be made available to credit unions to support the hiring of paid managers, with donor funding financing their salaries on a declining-share basis (100 percent the first year to 0 percent the fifth year), the building of basic infrastructure (e.g., a small office), the purchases of essential means of transportation and communication (e.g., motorcycles, bicycles, radio equipment), the acquisition of essential materials and equipment (e.g., a safe, calculators, micro computers), and the specialized technical assistance and training secured through participating NGOs.

In addition, funding will also be required to establish guarantee funds at different levels, which will primarily facilitate the market integration objective. These guarantee funds are discussed further below.

(ii) Conditionality

The satisfaction of objectives (b) though (e) above requires modifications, in some cases substantial changes, in the policies and procedures followed by credit unions.

- Increased membership and enhanced savings mobilization (objectives (b) and (c)) require clear and credible incentive policies. These should include better returns to savings deposits, better information to current and prospective members, savings campaigns offering non-monetary rewards, and other measures the specialized technical assistance suggested above will design.

- The improvement of lending policies and procedures (objective (d)) not only will result in better credit services, but also will contribute to enhance membership and savings mobilization, since a typical motivation to participate in credit unions is the expectation of obtaining loans.

New lending policies need to be open and understandable to all members, in order to eliminate member distrust, and make loan expectations a credible incentive to join and participate in credit unions.

A consequence of improved credit services provided by credit unions to members will be a reduction in the outflow of funds to the regional organizations and the Treasury, and a reallocation of the asset portfolio towards local lending. As a result, loan to deposit ratios should increase and approach the 40 percent limit established by existing regulations. Eventually, this regulation will become a binding constraint and will need to be revised.

- Conditionality associated with credit union financial assistance should also address crucial structural changes in the COOPEC/COOCEC/UCCEC system. As documented in this study, this system currently represents more a burden than a source of valuable services for participating credit unions (COOPECs), with negative effects on the quality of services these institutions provide to their members. Both horizontal and vertical (intra-movement) integration will greatly benefit from a re-organization of the regional/national credit union structures.

- Downward market integration, i.e., linkages with informal financial intermediaries, notably informal financial groups (IFGs), should be attained through mechanisms such as those recommended in Section C above. The adoption of appropriate deposit instruments to attract IFG pooled savings, or funds held by moneykeepers, should be made part of the conditionality package.

  In addition, guarantee funds could be established at the (reformed) regional credit union level, to support credit union lending to informal financial groups. Local credit unions, assisted by NGOs, could identify eligible (creditworthy) IFGs for on lending of credit union funds (not donor funds), under a guarantee fund administered at the regional level.

- Finally, upward market integration through linkages with the banking system could also make use of collateral funds established at one or more of the major commercial banks (BCZ, UZB, BZCE) to guarantee loans to individual credit unions. Other linkages, such as the use of commercial bank deposit services by individual credit unions, or by their regional and national associations, should be the result of the recommended improvements in credit union portfolio management.

(iii) Removal of Institutional Constraints

Policy and regulatory changes outside the credit-union movement are likely to be necessary to attain the objectives indicated above. Existing laws and regulation, such as BZ Ordinance Number 1, need to be carefully analyzed to determine the extent to which they represent constraints to credit-union development. The alleviation of these constraints is listed as a separate strategy component, since it may require the use of conditionality at the macro (regulatory) level, instead of directly into the credit union network.

3. Stages and Tentative Goals

A tentative outline of the first three implementation phases of the strategy is offered in Chapter II (section D) below.